

**RECONSIDERATION EVALUATION OF THE CERTIFICATE OF NEED
APPLICATION SUBMITTED ON BEHALF OF PROLIANCE SURGEONS, INC.,
PROPOSING TO ESTABLISH A FREE-STANDING AMBULATORY SURGERY
CENTER IN ISSAQUAH**

PROJECT DESCRIPTION

Proliance Surgeons, Inc., P.S. (PS, Inc.) is a Washington State corporation comprised of care centers, ambulatory surgery centers (ASCs), physical therapy, occupational therapy, and magnetic resonance imaging (MRI) facilities. Of these various types of healthcare facilities, only the ASCs are subject to Medicare certification. PS, Inc. manages and operates 33 physician offices, which are located within King, Pierce, Skagit, and Snohomish counties. Of the 33 physician offices, six have ASCs associated with them. The chart below illustrates six existing PS, Inc. ASCs. [source: CN historical files and PS, Inc. website]

County	Surgery Centers/City Location
King	Evergreen Orthopedic Surgery Center/Kirkland
	Evergreen Surgical Clinic/Kirkland
	Issaquah Surgery Center/Issaquah
	Valley Orthopedic Associates/Renton
Skagit	Skagit Island Orthopedic Surgery Center/Mount Vernon
Snohomish	Edmonds Center for Outpatient Surgery/Edmonds

This application focuses on the ASC located in Issaquah, known as Issaquah Surgery Center (in bold above). On November 17, 2003, the department granted an exemption to PS, Inc. for the establishment of this ASC located at 6505 226th Place SE, in the city of Issaquah, in King County. The exempt ASC became operational in April 2004, with two operating rooms (ORs), one procedure room, and support / staff areas. With the exemption, only those physicians part of the Proliance corporation are allowed access to the ASC. [source: CN historical files]

This application proposes to open the Issaquah Surgery Center to other physicians that are not part of the Proliance corporation. PS, Inc. indicates that local surgeons have requested access to the ASC. [source: Application, p11]

Because the project was approved in 2003 and became operational in 2004, the applicant contends that there is no capital cost associated with opening the existing exempt surgery center to other physicians. Consistent with similar applications, because the facility had recently become operational, the department disagreed with this contention. In response to the department's request, the applicant identified a capital cost of \$1,933,501.

On April 1, 2005, the department received the application from Proliance Surgeons, Inc. (Proliance). On August 3, 2005 the department received an application from Swedish Health Services (SHS), also proposing to establish an ambulatory surgical facility in Issaquah. Consistent with the public policy goals contained in Revised Code of Washington (RCW) chapter 70.38 that the development or expansion of health care facilities be accomplished in a

planned, orderly fashion and without unnecessary duplication, the department determined that the two applications should undergo review on a common timetable.

During this review process, both applications were evaluated following a common timeline. At completion of this review process, a single evaluation is issued that discusses the merits of each application. In the case of a review involving two potentially competing projects, the department's evaluation makes recommendations regarding whether both, neither or one of the individual applicants should be issued a certificate of need.

On May 12, 2006, the department issued its initial analysis, issuing a conditional approval of the SHS project and denying the Proliance project for failure to meet the criteria of financial feasibility and cost containment. On June 9, 2006, Proliance requested reconsideration of the department's decision under the provisions of Washington Administrative Code (WAC) 246-310-560. The department agreed to conduct reconsideration and a public hearing on the Proliance reconsideration motion was conducted on August 8, 2006. The public hearing was attended by representatives of Proliance and SHS. No other parties provided comment or participated in the reconsideration process.

This evaluation discusses those review criteria reconsidered by the department, and supplements, rather than supplants, the department's May 12, 2006, evaluation.

APPLICABILITY OF CERTIFICATE OF NEED LAW

This project is subject to Certificate of Need review as the establishment of a new health care facility under the provisions of Revised Code of Washington (RCW) 70.38.105(4)(a) and Washington Administrative Code (WAC) 246-310-020(1)(a).

APPLICATION CHRONOLOGY

March 2, 2005	ISC letter of intent submitted
March 1, 2005	ISC application submitted <ul style="list-style-type: none">• Screening activities and responses• Second screening activities and responses
June 20, 2005	SHS letter of intent submitted
August 3, 2005	SHS application submitted <ul style="list-style-type: none">• Screening activities and responses• Second screening activities and responses
August 12, 2004	Department begins review of applications
December 9, 2005	Public hearing conducted in Issaquah <ul style="list-style-type: none">• Rebuttal comments submitted by applicants and affected parties
May 12, 2006	Department's initial decision date
June 9, 2006	ISC reconsideration request submitted
August 8, 2006	Reconsideration hearing conducted in Issaquah
September 22, 2006	Department's anticipated reconsideration decision date
September 28, 2006	Department's actual reconsideration decision date

AFFECTED PARTIES

Two entities sought and were granted affected person status under WAC 246-310-010 during the initial review of this project:

- Overlake Hospital Medical Center, an acute care hospital located in Bellevue
- Overlake Surgery Center, an ambulatory surgery center located in Bellevue

Because of the simultaneous review of the two applications, ISC and SHS were considered affected parties to one another's applications. During the reconsideration process, SHS was the only affected person that participated.

SOURCE INFORMATION REVIEWED

- Issaquah Surgery Center's Certificate of Need Application (March 1, 2005)
- Issaquah Surgery Center's supplemental information (July 21, 2005, October 6, 2005; November 4, 2005)
- Issaquah Surgery Center's reconsideration request (June 9, 2006)
- Issaquah Surgery Center's reconsideration hearing submission and testimony (August 8, 2006)
- Public Comment received at public hearing and throughout the review and reconsideration processes
- Issaquah Surgery Center, Swedish Health Services, Overlake Hospital and Medical Center, and Overlake Surgery Center's rebuttal comments (December 28, 2005)
- Historical charity care data obtained from the Department of Health's Office of Hospital and Patient Data Systems (2002, 2003, and 2004 summaries)
- Population data obtained from the Office of Financial Management
- Facility survey information provided by the Department of Health's Office of Health
- Physician licensing data provided by the Department of Health's Medical Quality Assurance Commission.
- Information obtained from the website of Proliance Surgeons

CRITERIA EVALUATION

To obtain Certificate of Need approval, the applicants must demonstrate compliance with the criteria found in WAC 246-310-210 (need); 246-310-220 (financial feasibility); 246-310-230 (structure and process of care); 246-310-240 (cost containment) and WAC 246-310-270 (ambulatory surgery).¹

CONCLUSION:

For the reasons stated in this evaluation, and with the following term and conditions, Proliance Surgeons, Inc., is approved to establish an ambulatory surgery center in Issaquah, within King County:

¹ Each criterion contains certain sub-criteria. The following sub-criteria are not relevant to this project: WAC 246-310-210(3), (4), (5), and (6).

Term:

1. Prior to completion of the project, Issaquah Surgery Center will provide the department with an executed copy of the lease agreement between ACS Northwest Properties, LLC and Proliance Surgeons, Inc., consistent with the draft agreement provided in the application and consistent with the lease costs represented in the application and reconsideration submissions.

Conditions:

1. Issaquah Surgery Center will provide charity care in compliance with the charity care policies provided in its Certificate of Need application and the requirements of the applicable law. Issaquah Surgery Center will use reasonable efforts to provide charity care in an amount comparable to the average amount of charity care provided by hospitals affected by the proposed ambulatory surgical facility, during the three most recent years. For historical years 2002-2004, these amounts are 1.15% of total revenue and 1.85% of adjusted revenue. Issaquah Surgery Center will maintain records documenting the amount of charity care it provides and demonstrating its compliance with its charity care policies and applicable law and report by March 31 of each year the amount of charity care provided during the previous calendar year.
2. Issaquah Surgery Center shall maintain Medicare certification and a Medicaid contract.

A. Need (WAC 246-310-210)

Based on the source information reviewed, the department determines that the application is consistent with the need criteria in WAC 246-310-210(1) and (2) and WAC 246-310-270

(1) The population served or to be served has need for the project and other services and facilities of the type proposed are not or will not be sufficiently available or accessible to meet that need

In its initial review of this project, the department concluded that the applicant had demonstrated a need for additional OR capacity in the East King planning area. That conclusion is unchanged by the applicant's request that the department reconsider its conclusions regarding this project's compliance with the financial feasibility and cost containment criteria of Certificate of Need.

(2) All residents of the service area, including low-income persons, racial and ethnic minorities, women, handicapped persons, and other underserved groups and the elderly are likely to have adequate access to the proposed health service or services.

In its initial evaluation, the department concluded that any approval of this project would be conditional upon ISC agreeing to use reasonable efforts to provide charity care in an amount comparable to the average amount of charity care provided by hospitals affected by the proposed ambulatory surgical facility, during the three most recent years.

The department concludes that, subject to the condition discussed above, there would be reasonable assurance that all residents of the service area would have access to the services proposed by ISC. This conclusion is unchanged by the reconsideration process, therefore this sub-criterion is met.

Financial Feasibility (WAC 246-310-220)

Based on the source information reviewed, the department determines that the applicant has met the financial feasibility criteria in WAC 246-310-220.

(1) The immediate and long-range capital and operating costs of the project can be met.

The anticipated capital cost of this project is \$ 1,933,501 of which \$691,332 is to be spent on equipment, with the remaining \$1,242,169 dedicated to construction and the additional fees and costs associated with configuring the leased space to meet the requirements of an ASC. The applicant intends to finance the project through an interfund loan from Proliance Surgeons and two notes held by US Bank. The proposed facility is leased from an entity known as ACS Northwest Properties, LLC, a partnership made up entirely of Proliance employees. ACS, in turn, leases the land from Lakeside Industries.

ISC does not yet have audited financial reports. The projected first-year balance sheet for ISC is shown in Table I on the following page:

Table I
ISC Balance Sheet
First Year of Operation

	Assets		Liabilities
Cash	10,000	Line of Credit - Proliance	\$ 273,251
Total Assets	\$ 10,000	Total Liabilities	\$ 273,251
		Retained Earnings	(263,251)
		Total Liabilities and Equity	\$ 10,000

As stated in the project description portion of the evaluation, the physical space and equipment for the ASC are leased from ACS Northwest Properties, which leases the building from Lakeside Industries. When questioned about this balance sheet, the applicant provided the following response:

“Additionally, you have asked for an explanation to detail the lack of such items as fixed assets, long-term liability, and owner’s equity. The reason there is an absence of these items is secondary to the proforma simply representing a cash-based income statement and balance sheet. In addition, the assets and liabilities of ISC are those of ASC (sic) Northwest Properties, LLC owns the facility and not of Proliance Surgeons, Inc P.S., which only has rent and lease expenses.” [source: November 4, 2005, supplemental screening responses, p2]

CN staff reviewed ISC’s projected balance sheets to determine if the project would be able to meet its short and long term financial obligations. The projected balance sheet for the third year of operation is shown in Table II below:

Table II
ISC Balance Sheet
Third year of Operation

	Assets		Liabilities
Cash	\$ 10,000	Line of Credit – Proliance	\$ 87,501
Total Assets	\$ 10,000	Total Liabilities	\$ 87,501
		Retained Earnings	(77,501)
		Total Liabilities and Equity	\$ 10,000

Based on the above information, with total assets of only \$10,000, the department could not conclude that ISC can be reasonably expected to be able to meet its short and long term financial obligations. The applicant did not provide historical or projected balance sheets for ACS Northwest Properties, LLC during the initial review period. During reconsideration, however, ISC provided projected balance sheets for ACS Northwest. The projected balance sheet for ACS for the third year of operation is shown in Table III, on the following page:

Table III
ACS Northwest Properties, LLC
Balance Sheet
Third year of Operation

Assets		Liabilities	
Cash	\$ 38,312	Miscellaneous Payables	\$ 2,248
Deposits	2,500	Long Term Debt	973,978
Property and equipment	1832097	Total Liabilities	\$ 976,226
Accumulated Depr	(575,090)		
Intangibles	24,952	Partner's Capital	\$ 327,730
Accumulated Amortization	(18,815)	Total Equity	\$ 327,730
Total Assets	1,303,956	Total Liabilities and Equity	1,303,956

The department concludes that the balance sheets provided for ACS Northwest Properties, when viewed in conjunction with the balance sheets of ISC, reassure the department that the short and long-term financial obligations of this project can be met.

During the review process, ISC provided two different pro forma income statements; one constructed to reflect ISC's anticipated surgical volume with the increased staffing discussed earlier in the application, and one reflecting only the volume projected for its existing staff of five surgeons. Table IV below shows the projected revenues, expenses, and net income projected by the applicant for the first three years of operation for the facility assuming the increased staffing and volumes projected to occur if a CN is awarded to this facility:

Table IV
ISC Projected Revenue and Expenses

	Year 1	Year 2	Year 3
Number of Procedures	817	858	972
Net Patient Revenue	\$ 958,000.98	\$ 1,699,649.58	\$ 1,817,971.34
Operating Expense	1,221,251.49	1,635,251.07	1,696,619.03
Net Income	\$ (263,250.51)	\$ 64,398.50	\$ 121,352.31
Operating Revenue per Surgery	1,172.58	1,980.94	1,870.34
Operating Expense per Surgery	1,494.80	1,905.89	1,745.49
Net Income per Surgery	\$ (322.22)	\$ 75.06	\$ 124.85

Under this set of assumptions, the ASC will operate at a loss in year one, but will be operating at a profit in the second and subsequent years.

In its initial evaluation, the department noted, however, that rent identified in ISC's pro-forma income statement was identified at \$143,272.73 in the first year, increasing to \$195,094.42 in the third year. The draft lease agreement between Proliance and ACS Northwest provided in the applicant's July 21, 2005, responses to screening questions contains a schedule illustrating total monthly rent for the first five years of the lease term. Those estimates are depicted in table V, on the following page:

Table V
ISC Estimated Total Monthly Rent

Lease Period	Total Monthly Rent
April-June 2004	\$38,216.06
July 2004-April 2005	\$50,522.49
May 2005-April 2006	\$57,906.10
May 2006-April 2007	\$62,876.48
May 2007-April 2008	\$63,720.58
May 2008-April 2009	\$64,148.98

From the monthly rent estimates above, the department calculated estimated annual rent for this facility for 2006 to be \$733,916.24. This is \$590,633.51 more than estimated in ISC's pro forma income statement provided in its July 21, 2005 screening responses and included in the Operating Expense amounts depicted in Table IV, on page 7 of this evaluation. This amount is also \$104,028.24 more than the combined "Rent/Debt Service" line in the revised pro-forma income statement provided by ISC to depict the 5-physician estimate discussed above.

Estimated monthly rent for calendar year 2008 would be \$768,074.16, which exceeds the applicant's projected 2008 "Rent/Debt Service" line by \$131,491.16. That difference exceeds the net profit of the facility in the third year of operation in both pro-forma income statements provided by the applicant. The department was unable to locate any information in the application or screening responses that would explain this discrepancy, and denied the application based, in part, on this information.

During the reconsideration process, the department was provided with a detailed explanation of the lease amounts relied upon by the applicant and the applicant's method of allocating costs to the ASC. During the reconsideration hearing, ISC explained that the lease amounts contained on the draft sub-lease between ACS and Proliance were incorrect and that the lease expenses allocated to the ASC should be 78% of the lease amounts identified in the executed master lease agreement. Using that document, the applicant demonstrated that the pro forma income statements and the lease agreement are consistent. The department's review of the calculations provided by ISC supports this contention. The department concludes, however, that this analysis can only be relied upon if the actual lease amounts paid to ACS by Proliance are consistent with the amounts presented during reconsideration. The department concludes that approval of this project on reconsideration must be conditional upon receipt of an executed copy of the sublease between ACS and Proliance, with monthly lease amounts consistent with those presented by the applicant during the review and reconsideration process.

Based on this information, and subject to the condition discussed above, the department concludes that the long-term capital and operating costs of this project can be met.

(2) The costs of the project, including any construction costs, will probably not result in an unreasonable impact on the costs and charges for health services.

The department has examined the projected revenues and expenses per procedure of this project against other similar proposals and concludes that the charges projected by the applicant are reasonable and, based on the utilization projections provided, could be expected to be sufficient

to cover the short and long-term costs of this ASC without resulting in an unreasonable increase on the costs and charges for health services in the service area. Subject to the condition discussed in (1), above, this sub-criterion is met.

(3) The project can be appropriately financed.

As noted above, this project is financed through an interfund loan from Proliance Surgeons and two notes held by US Bank. The materials submitted to the department during the initial application period were unclear as to the purposes and amounts of the various loan documents. In the initial application the applicant did not provide details about the US Bancorp business loans or the interfund loan. In addition, the applicant failed to respond to the department's request to explain its chosen financing method and to document why it was the most prudent financially.

Given the doubt created by the discrepancies among the various income statements provided by the applicant, the department was unable to conclude that ISC would be able to meet the obligations incurred in financing this project.

During the course of reconsideration, the applicant provided information documenting the amounts and purposes of the various loans associated with this project. At the reconsideration hearing, Proliance stated that the initial capital costs of the project are to be financed by the US Bank notes, debt incurred by ACS in order to develop the facility. The applicant provided copies of the relevant loan agreements, noting that the annual cost of financing the project is actually \$168,000 less than projected in the initial application. The inter-fund loan from Proliance is not documented with a formal agreement, rather it represents the parent organization's commitment to fund the deficits projected in the first year of operation.

With the clarifications discussed above, the department concludes that the applicant has demonstrated that the project can be appropriately financed, and this sub-criterion is met.

C. Structure and Process (Quality) of Care (WAC 246-310-230)

Based on the source information reviewed, the department determines that the applicant has met the structure and process (quality) of care criteria in WAC 246-310-230.

(1) A sufficient supply of qualified staff for the project, including both health personnel and management personnel, are available or can be recruited.

As stated in the initial evaluation, the department concluded that although the state of Washington is currently experiencing a shortage of nurses, ASCs have been able to demonstrate an ability to hire qualified staff, in part because of more attractive work hours and environment than other health care settings. These factors, coupled with population increases in the service area and the applicant's pool of existing employees, lead the department to conclude it is reasonable to expect the applicant to be able to hire sufficient qualified staff to operate the proposed facility. This conclusion is unchanged and this sub-criterion continues to be met.

(2) The proposed service(s) will have an appropriate relationship, including organizational relationship, to ancillary and support services, and ancillary and support services will be sufficient to support any health services included in the proposed project.

The department's conclusions for this sub-criterion are unaffected by the reconsideration and therefore this sub-criterion continues to be met.

(3) There is reasonable assurance that the project will be in conformance with applicable state licensing requirements and, if the applicant is or plans to be certified under the Medicaid or Medicare program, with the applicable conditions of participation related to those programs.

In its initial evaluation, the department concluded that given the compliance history of all the ASCs owned and/or operated by Proliance and the compliance history of the medical director and staff currently associated with the ASC, there is reasonable assurance that Proliance would continue to operate the ASC in conformance with applicable state and federal licensing and certification requirements. This conclusion is unchanged as a result of the reconsideration and this sub-criterion continues to be met.

(4) The proposed project will promote continuity in the provision of health care, not result in an unwarranted fragmentation of services, and have an appropriate relationship to the service area's existing health care system.

In its initial evaluation the department concluded that there is reasonable assurance that this project would promote continuity of care. Further, the department concludes that ISC's current relationships within the existing health care system would continue and not result in an unwarranted fragmentation of services. These conclusions are unchanged on reconsideration and this sub-criterion continues to be met.

(5) There is reasonable assurance that the services to be provided through the proposed project will be provided in a manner that ensures safe and adequate care to the public to be served and in accord with applicable federal and state laws, rules, and regulations.

This sub-criterion is addressed in sub-section (3) above and is met.

D. Cost Containment (WAC 246-310-240)

Based on the source information reviewed, the department determines that the applicant has met the cost containment criteria in WAC 246-310-240.

(1) Superior alternatives, in terms of cost, efficiency, or effectiveness, are not available or practicable.

ISC states that "Because of the extreme lack of available operating room space in Issaquah, there were few explored alternatives." [source: July 21, 2005, screening responses, p25] The applicant continues, "Once a decision had been reached to extend services from Renton into the Issaquah area, a search was completed for available office and surgery space. The decision was reached to not postpone action due to the desire and need to be the only group of general surgeons in the Issaquah area. It was felt that a group of surgeons, who already practice in the area, would better serve the patients of the area." The applicant further states that it continues evaluate other options. ISC states that it has considered merging with other entities or entering into shared leasing arrangements, but that the CN proposal presented is its preferred option because it would

allow continuous management of the facility, not change the management structure of the other physicians, and have a low impact on staffing because a shared leasing arrangement would require separate staff.

The department concludes that, given the identified need in the planning area for additional OR capacity, superior alternatives to the projects proposed do not exist. In light of the level of utilization of the current providers and the amount of need projected for 2009, other surgical alternatives are not available in the planning area.

(2) In the case of a project involving construction:

(a) The costs, scope, and methods of construction and energy conservation are reasonable;

This criterion is evaluated in section B(2), above, and is met.

(b) The project will not have an unreasonable impact on the costs and charges to the public of providing health services by other persons.

This criterion is evaluated in section B(2), above, and upon reconsideration is met.